Challenges to the Free Trade Area of the Americas

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In 1989, Lester Thurow, the well-known MIT economist, declared, "GATT is dead." Trade talks were adrift and the leading trading powers seemingly unwilling to address the major barriers protecting their domestic markets. Yet four years later, Thurow's prophecy was forgotten and the Uruguay Round of GATT negotiations successfully concluded.

In 2002, Thurow-like critiques now target another trade negotiation, the ambitious venture of the widely divergent countries of North and South America to craft a "Free Trade Area of the Americas" (FTAA). Government leaders committed at the Miami Summit of the Americas in December 1994 to negotiate a hemispheric free trade pact by 2005. After three years of preparations, the Santiago Summit in April 1998 formally launched the negotiations. Hemispheric leaders then reaffirmed their mandate at the Quebec City Summit soon after President Bush took office.

The FTAA initiative is now almost eight years old. Lots of meetings have taken place, but scant progress has been made on the principal task of eliminating restrictions on trade in goods and services that block access to foreign markets. Indeed, those talks have barely begun. Many countries seem distracted by pressing international actions against terrorism as well as domestic economic and political problems. Not surprisingly, questions have been raised whether governments can fulfill their lofty Summit promises—or whether they even still want to do so.

The FTAA negotiations have had a star-crossed history. Each summit meeting has been followed by serious financial crises in the region that have called into question the viability of the FTAA talks. The Miami Summit was followed almost immediately by the collapse of the Mexican peso; the optimism from the Santiago Summit faded several months later in the wake of the Brazilian financial crisis of 1998-99; and the Quebec City Summit was soon overshadowed by the still-evolving crisis in Argentina. Each crises tested national resolve to sustain domestic reforms and to pursue regional integration initiatives. In most cases, countries tended to reinforce their economic reforms instead of retrenching—though Argentina and Venezuela have raised some trade barriers and others have delayed privatization programs.

To be sure, the current economic and political problems in the hemisphere are more complex and daunting than the localized crises of the past decade. The Argentine crisis, economic stagnation in the region, political instability in the Andean region, armed insurrection in Colombia, and drug-related violence in the Caribbean Basin raise major concerns about Latin American participation in the FTAA. At the same time, new US farm subsidies and steel import restrictions provoke questions regarding what Latin American countries actually can gain from the trade pact. If governments do not adequately address these current problems, they could lose public support for continuing to pursue the longer run benefits of the free trade pact.

What are the prospects for the FTAA negotiations? As trade officials prepare for the next FTAA ministerial in Quito in October 2002, the unbridled optimism of the Quebec City Summit seems to have given way to untempered pessimism. This mood swing reflects three broad concerns about the FTAA process:

> 1. Will economic growth be sufficient to sustain public support for trade and other economic reforms? To put the argument in simple terms, lower growth means a smaller economic pie to divide among national constituencies; workers and firms face harsher adjustments; and fewer revenues are generated to fund social safety net programs. Since the relative boom of 2000, when economic growth in Latin America and the Caribbean (LAC) averaged 4 percent, the region has suffered two years of stagnation and rising unemployment. Argentina faces an economic depression of a magnitude seen recently only in the transitional economies of the former Soviet Union. Despite high oil prices, Venezuela's economy is in recession and likely to contract by 5 percent or so this year. Most other countries are in the black, but growth is anemic—particularly in the two largest economies, Brazil and Mexico, that have been sideswiped by economic downturns in their neighborhood.
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> 2. Will current political strife in Argentina and the Andean region erode support for new trade reforms—or worse, be so destructive as to lead to a wave of "failed states" that consequently are unable to participate in a hemispheric pact? Such an outcome seemed unthinkable in the pro-democracy boom-let of the 1990s in Latin America. Since then, however, Argentina has endured a parade of presidents in December 2001-January 2002; Ecuador disposed of five presidents of its own at a somewhat more leisurely pace in the late 1990s; the plague of military coups

resurfaced in Venezuela; drug-related violence spread in the Caribbean Basin; and the peace process broke down in Colombia.

3. How committed is the United States to liberalizing its own well-entrenched trade barriers? The new US farm bill and steel import safeguards, coupled with Congressional demands to "strengthen" US antidumping laws, provoke skepticism in Latin America about the willingness of US officials to open their market to foreign competition. Brazilian President Fernando Henrique Cardoso bluntly warned that an FTAA would be "welcome if its creation is a step toward providing access to more dynamic markets…otherwise, it would be irrelevant or, worse, undesirable" (http://usinfo.state.gov/regional/ar/summit).

The current economic and political difficulties in Latin America lead some FTAA pundits to project a dismal outlook for hemispheric initiatives. But similar pessimistic projections were made in 1995 when the "tequila effect" of the Mexican peso crisis infected Argentina and others in Latin America; yet Latin American countries generally recovered strongly in the second half of the decade and continued to deepen their economic reforms and integration initiatives. While the immediate challenges seem daunting, the medium term outlook remains positive, for several reasons.

First, economic prospects are improving, albeit from the weak base of 2001-2002. Overall, the Inter-American Development Bank predicts growth of 3 percent for the Latin America and Caribbean region in 2003 (compared to -1.3 percent in 2002). Even the Argentine forecast presages less volatility, inflation, and positive growth in 2003—albeit at income levels well below those of the late 1990s. New IMF loans already have strengthened the financial reserves of Brazil and Uruguay, and likely will help restructure the disabled Argentine banking system in 2003.

To be sure, Brazil is a big wild card in this forecast. If the new government can calm financial markets, interest rate spreads will narrow, the real will appreciate from its current depressed levels, and the economy could achieve growth of 4 percent or more. However, market participants are hedging their bets on the likelihood of such a benign result; indeed, Brazilian debt carries a risk premium of around 2000 basis points, indicating a strong fear of default in 2003. A new debt crisis would likely delay, though probably not derail, the FTAA and other economic initiatives in the hemisphere.

In addition to the small up-tick in growth, there are other positive economic developments in the LAC region that bode well for the FTAA:

- Despite populist rhetoric in a number of countries, the traditional political reaction to hard times in Latin America, lurching back to protectionism, has been limited. Argentina raised tariffs on many consumer goods to counter its overvalued peso, but after the currency peg collapsed, so too did the need for the import barriers. Indeed, depreciating currencies throughout the region effectively protect many domestic industries by making imports more costly—thus obviating the need for import restrictions. The down side is that weaker currencies also hinder some local firms that require imported components to maintain their international competitiveness.

- Free trade continues to attract, not repel, Latin American governments. The continuing spread of free trade agreements in the region, especially those involving the industrial economies of North America, create important way stations on the road to the FTAA.

- The physical integration of the region continues to grow, admittedly slower than in the 1990s, as countries pursue regional infrastructure projects that link power grids and gas pipelines, and expand road and rail transport networks. Such investments in concrete and steel create durable examples of the benefits of regional integration.

Second, several LAC countries are plagued with ineffective governments and face populist opposition, but their governance problems seem unlikely to devolve into a crisis of "failed states". Political regimes may remain weak in several LAC countries, but left- or right-wing regimes have few viable alternatives to continuing to pursue trade and investment reforms if their industries and workers are to keep pace of global competitors. Import-substitution policies failed in past decades and are even less viable in a world of increasingly globalized markets. Today, countries need to adapt more quickly to rapidly changing developments in global markets; standing pat means falling behind. Moreover, countries that have had relatively closed economies (in terms of the ratio of trade to GDP), such as Brazil and Argentina, need to sharply expand their exports to meet their growth objectives—and the FTAA and WTO negotiations offer the prospect of increased access to the world's richest markets.

Third, liberalization of US trade barriers in an FTAA is now more promising due to three important developments over the past year:

- The US Congress has finally provided, after a hiatus of eight years, a comprehensive negotiating mandate to pursue the FTAA. The passage of Trade Promotion Authority in 2002 empowers US trade officials to put all US barriers on the negotiating table without exception. To be sure, Congress has set onerous consultation and reporting requirements on reforms of the most politically sensitive issues, but such actions would have been necessary—even without the legislative mandate—to build domestic political support for the results of the trade negotiations.

- The launch of new WTO negotiations at the Doha Ministerial in November 2001 is also crucial to the success of the FTAA. The two sets of talks are integrally linked—both by timetable and substance. Each targets completion of negotiations by January 2005 and phase-in of the agreed reforms over the following 5 to 10 years, plus trade officials confront similar broad based agendas. In some areas such as reform of farm subsidies, progress in the WTO talks is necessary for the FTAA talks to succeed since FTAA disciplines could be undercut unless European and other countries also adhere to the same obligations.

- In the WTO negotiations, US trade officials tabled a radical proposal to substantially cut farm subsidies and import barriers. In so doing, they indicated a willingness, if WTO talks are successful, to reverse many of the new US subsidies recently incorporated in the 2002 farm bill.

In sum, the FTAA talks are on track, though negotiators have not moved very far down the tracks. But the positive developments of the past year, and the emerging recovery of Latin American economies in 2003, provide grounds for fragile optimism. I say fragile because much depends on the health of the Brazilian economy and the political will of the leading trading nations of North and South America to build a free trade regime for their mutual benefit. In November 2002, the United States and Brazil will assume the co-chairmanship of the FTAA talks for their duration. The two countries have worked well together over the past year to launch the Doha Round, minimize the impact of US steel safeguards on Brazilian exports, and to secure $30 billion in IMF financing for Brazil to help manage its debt problems. Hopefully, they will build on these precedents to lead the FTAA negotiations to a successful conclusion.

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